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American Institute of Certified Public Accountants. Accounting and Review Services Committee

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EXPOSURE DRAFT

PROPOSED STATEMENT ON STANDARDS FOR ACCOUNTING AND REVIEW SERVICES: COMPILATION AND REVIEW OF FINANCIAL STATEMENTS

JANUARY 20, 1978

**Issued by the Accounting and Review Services Committee of the
American Institute of Certified Public Accountants
For Comment From Persons Interested in Accounting and Review Services**

**Comments should be received by June 30, 1978, and addressed to
William J. Haggerty, CPA, File Ref. No. 9000
AICPA, 1211 Avenue of the Americas, New York, N.Y. 10036**

January 20, 1978

To Practice Offices of CPA Firms; Members
of Council; Technical Committee Chairmen;
State Society and Chapter Presidents,
Directors and Committee Chairmen; Organizations
Concerned With Regulatory, Supervisory,
or Other Public Disclosure of Financial
Activities; Persons Who Have Requested Copies:

An exposure draft of a proposed Statement on Standards for Accounting and Review Services entitled "Compilation and Review of Financial Statements" accompanies this letter.

The proposed Statement has been prepared by the Accounting and Review Services Committee. The Committee is the senior technical committee of the Institute authorized to develop, on a continuing basis, standards concerning the accounting and review services a CPA may render in connection with unaudited financial statements or other unaudited financial information of an entity that is not required to file financial statements with a regulatory agency in connection with the sale or trading of its securities in a public market. The responsibilities of the Committee do not include any of the responsibilities of the Accounting Standards Executive Committee.

The Committee has selected the CPA's involvement with unaudited financial statements as the subject matter of its first pronouncement. The Committee recognizes that CPAs perform various types of services in connection with unaudited financial statements or other unaudited financial information, but believes that the subject matter of this proposed Statement should be addressed first.

The Committee believes that, with respect to entities whose securities are not publicly traded, existing AICPA pronouncements do not meet the needs of such entities for different levels of accounting and review services, the needs of users of the financial statements of those entities for different forms of assurance, or the needs of CPAs who prepare or review those statements for specific guidance. For example, although present standards do not require the CPA to perform any procedures with respect to unaudited financial statements with which he is associated, many CPAs do perform certain procedures. However, the CPA is required to issue the same disclaimer of opinion whether or not he performs any procedures. Also, present standards permit the CPA to prepare financial statements that omit substantially all of the disclosures required by generally accepted accounting principles, or another comprehensive basis of accounting, provided the CPA's disclaimer indicates that the statements

are restricted to internal use by the client. However, the CPA has no control over the distribution of financial statements by his client and such "internal use only" statements are frequently provided to creditors and others.

The Committee has concluded that CPAs presently perform two types of service with respect to unaudited financial statements: (1) review of financial statements, in which the CPA performs certain procedures to achieve a level of assurance and (2) compilation of financial statements, in which the CPA ordinarily performs few, if any, procedures. The proposed Statement recognizes these two services and provides separate standards for each.

Section 516 of Statement on Auditing Standards No. 1 provides that a CPA is associated with unaudited financial statements if he consents to the use of his name in connection with those financial statements or if he submits to his clients or others financial statements that he has prepared or assisted in preparing. Section 516 further provides that unaudited financial statements should be accompanied by a disclaimer of opinion if a CPA is associated with them. This proposed Statement would replace these requirements by specifying (1) the services a CPA may perform in connection with unaudited financial statements and (2) the form of report to be issued for each service.

If this proposed Statement is adopted, the Auditing Standards Executive Committee will be requested to consider certain changes in SAS No. 1, sections 516 and 517, and to withdraw the Guide For Engagements of CPAs to Prepare Unaudited Financial Statements.

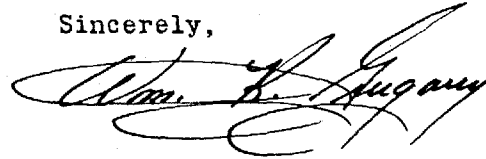
The Committee recognizes that there are differences between the review procedures required by the proposed Statement and the procedures required by SAS No. 10 in connection with a limited review of interim financial statements, and also between the form of review report recommended in the proposed Statement and the disclaimer of opinion required by SAS No. 13. A joint task force consisting of members of the Committee and the Auditing Standards Executive Committee has been formed to consider these differences and prepare recommendations on the manner in which they should be resolved. Respondents are specifically requested to comment on the applicability of the review standards included in the proposed Statement to interim financial statements of an entity whose most recent annual financial statements have been examined by the CPA in accordance with generally accepted auditing standards.

Questions may be raised about whether a review report may be issued in the situations addressed in SAS No. 1, sections 509.10 and 509.45-.47; that is, when a CPA who has been engaged to conduct an examination in accordance with generally accepted auditing standards has been unable to apply all the procedures he considers necessary in the circumstances. Questions may also be raised concerning the standards for reporting on comparative financial statements when the financial statements for one, but not all, of the periods have been audited. These questions will also be referred to the joint task force for consideration and respondents are specifically requested to comment on these matters.

Comments on all aspects of the proposed Statement are sought and will be appreciated. They should be addressed to William J. Haggerty, CPA, File Ref. No. 9000, at the AICPA in time to be received by June 30, 1978. The Committee will be particularly interested in the reasons for the comments and suggestions submitted.

Written comments on the exposure draft will become part of the public record of the Accounting and Review Services Committee and will be available for public inspection at the library of the American Institute of Certified Public Accountants in New York City on and after July 10, 1978.

Sincerely,

A handwritten signature in dark ink, appearing to read "Wm. R. Gregory", with a stylized, flowing script.

Wm. R. Gregory, Chairman
Accounting and Review Services
Committee

WRG:pc
Enclosure

PROPOSED STATEMENT ON STANDARDS FOR ACCOUNTING AND REVIEW SERVICES

COMPILATION AND REVIEW OF FINANCIAL STATEMENTS

Statements on Standards for Accounting and Review Services establish standards concerning the services a CPA may render in connection with unaudited financial statements or other unaudited financial information of an entity that is not required to file financial statements with a regulatory agency in connection with the sale or trading of its securities in a public market.

INTRODUCTION

1. This Statement provides that a CPA may be engaged to *compile* or *review* annual or interim financial statements of an entity that is not required to file financial statements with a regulatory agency in connection with the sale or trading of its securities in a public market. This Statement provides guidance to CPAs concerning the standards and procedures applicable to such engagements.

2. This Statement defines the objectives of the CPA in a compilation engagement and a review engagement as follows:

- a. *Compilation of financial statements.* To present in the form of financial statements information supplied by an entity without achieving any assurance as to whether there are material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles or, if applicable, with a comprehensive basis of accounting other than generally

accepted accounting principles.¹

- b. *Review of financial statements.* To achieve, through the performance of inquiry and analytical procedures, limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles or, if applicable, with another comprehensive basis of accounting.

Whenever a CPA compiles or reviews financial statements, he should issue a report that describes the nature of the service provided and the limited responsibility assumed, except as provided in paragraphs 10, 30, and 35.

3. The term *financial statement* refers to a presentation of financial data, including accompanying notes, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with generally accepted accounting principles or another comprehensive basis of accounting.² Financial

¹ The term "comprehensive basis of accounting other than generally accepted accounting principles" is defined in SAS No. 14, paragraph 4, and is hereafter referred to in this Statement as "another comprehensive basis of accounting."

² Paragraphs 14-16 of this Statement provide guidance to the CPA when he is engaged to compile financial statements that omit substantially all of the disclosures required by generally accepted accounting principles or another comprehensive basis of accounting.

forecasts, projections, and similar presentations are not financial statements for purposes of this Statement. The following financial presentations are examples of financial statements:³

- a. Balance sheet.
- b. Statement of income.
- c. Statement of retained earnings.
- d. Statement of changes in financial position.
- e. Statement of changes in owners' equity.
- f. Statement of assets and liabilities (with or without owners' equity accounts).
- g. Statement of revenue and expenses.
- h. Summary of operations.
- i. Statement of operations by product lines.
- j. Statement of cash receipts and disbursements.

A financial statement may be, for example, that of a corporation, a consolidated group of corporations, a combined group of affiliated entities, a not-for-profit organization, a government unit, an estate or trust, a partnership, a proprietorship, a segment of any of these, or an individual.

4. This Statement does not establish standards for other services such as the following:

³ SAS No. 14, paragraph 7, provides guidance with respect to suitable titles for financial statements that are prepared in conformity with comprehensive bases of accounting other than generally accepted accounting principles.

- a. Preparing a working trial balance.
- b. Assisting in adjusting and closing the books of account.
- c. Accommodation typing or reproducing of financial statements and other data.
- d. Consulting on accounting, tax, and similar matters.
- e. Preparing tax returns.
- f. Various data processing services other than financial statement preparation.
- g. Processing financial data for other accounting firms.

A CPA is not precluded from performing services such as those above for entities for which the CPA performs a compilation or review service.

5. When a CPA accepts a compilation or review engagement, he should consider whether it will also be necessary for him to perform other services, such as assistance in adjusting and closing the books of account or consultation on accounting matters. Factors that a CPA should consider in making this determination include the complexity of the entity's business transactions, the form of the entity's accounting records, the stated qualifications of the entity's accounting personnel, the accounting basis on which the financial statements are to be presented, and the form and content of the financial statements.

6. The CPA should establish an understanding with the entity, preferably in writing, regarding the services to be performed. The understanding should include a description of the services to be performed and a description of the report the CPA expects to render. Examples of engagement letters are presented in Appendixes B and C to this Statement.

GENERAL STANDARDS OF THE PROFESSION

7. The following proposed general standards of the profession, when adopted, will be applicable to

the performance of engagements in all major areas of accounting practice:⁴

- a. *Professional competence.* A member shall undertake only those engagements which he or his firm can reasonably expect to complete with professional competence.
- b. *Due professional care.* A member shall exercise due professional care in the performance of an engagement.
- c. *Planning and supervision.* A member shall adequately plan and supervise an engagement.
- d. *Sufficient relevant data.* A member shall obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to an engagement.

COMPILATION OF FINANCIAL STATEMENTS

Objective of Compilation

8. The objective of a compilation of financial statements is to present in the form of financial statements information supplied by an entity without achieving any assurance as to whether there are material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles or, if applicable, with another comprehensive basis of accounting.

Compilation Standards

9. The CPA should obtain a

⁴ The proposed general standards, which would amend the Code of Professional Ethics of the AICPA, have been approved by Council for submission to the membership, who will vote on the adoption of such standards. The proposed general standard entitled "Reporting," which prohibits a member from using his name in conjunction with any forecast of future transactions in a manner which may lead to the belief that the member vouches for the achievability of the forecast, is not included above because the scope of this Statement does not include financial forecasts, projections, and similar presentations.

level of knowledge of the accounting principles and practices of the industry in which the entity operates that will enable him, using information supplied by the entity, to compile financial statements that are appropriate in form for an entity operating in that industry. This standard does not prevent a CPA from accepting a compilation engagement for an entity in an industry with which the CPA has no previous experience. It does, however, place upon the CPA a responsibility to achieve the required level of knowledge. He may do so, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, or individuals knowledgeable about the industry.

10. When the CPA performs a compilation service, he is not required to make inquiries or perform other procedures regarding the information supplied by the entity. However, if the CPA becomes aware, during the performance of a compilation engagement, that information supplied by an entity is incorrect, incomplete, or otherwise unsatisfactory for the purpose of compiling financial statements, he should request the entity to provide additional or revised information. If the entity refuses to provide additional or revised information, the CPA should withdraw from the compilation engagement. (See paragraphs 34 and 35 for the CPA's responsibilities when he is aware of departures from generally accepted accounting principles or another comprehensive basis of accounting.)

11. The CPA should read the financial statements that he has compiled and consider whether such financial statements appear to be appropriate in form and free from obvious material errors. In this context, the term *error* refers to mistakes in the compilation of financial statements, including arithmetic or clerical mistakes, and mistakes in the application of accounting principles.

Reporting on the Financial Statements

12. Financial statements compiled by a CPA without audit or review should be accompanied by a report stating that:

- a. A compilation service has been performed.
- b. All information included in the financial statements is the representation of the management (owners) of the entity.
- c. A compilation service is limited to the presentation in the form of financial statements of information supplied by management (owners) without the achievement by the CPA of any assurance as to whether there are material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles or another comprehensive basis of accounting.

Each page of the financial statements compiled by a CPA should include a reference to the CPA's report, such as "See Accompanying CPA's Report."

13. The following form of standard report is appropriate for a compilation service:

I (we) have performed a compilation service in connection with the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

Users of these financial statements should be aware that a compilation service is limited to the presentation in the form of financial statements of information supplied by management (owners) and that I (we) have not achieved any assurance as to whether there are material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles (other comprehensive basis of accounting).

Reporting on Financial Statements That Omit Substantially All Disclosures⁵

14. An entity may request a CPA to compile financial statements that omit substantially all of the disclosures required by generally accepted accounting principles or another comprehensive basis of accounting, including disclosures that might appear in the body of the financial statements. The CPA may compile such financial statements provided the omission of substantially all disclosures is clearly indicated in his report and is not, to his knowledge, undertaken with the intention of misleading those who might reasonably be expected to use such financial statements. When the entity wishes to include disclosures about only a few matters in notes to such financial statements, such disclosures should be labeled as "Selected Information—Substantially All Disclosures Required by Generally Accepted Accounting Principles (Other Comprehensive Basis of Accounting) Are Not Included."

15. When financial statements that the CPA has compiled omit substantially all disclosures, the following form of standard report is appropriate:

I (we) have performed a compilation service in connection with the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

Users of these financial statements should be aware that a compilation service is limited to the presentation in the form of financial statements of information supplied by management (owners) and that I (we) have not achieved any assurance as to whether there are

material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles (other comprehensive basis of accounting).

Users of these financial statements should also be aware that management has elected to omit substantially all of the disclosures (and the statement of changes in financial position) required by generally accepted accounting principles (other comprehensive basis of accounting). If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the Company's financial position, results of operations, and changes in financial position.

16. Notwithstanding the above, financial statements compiled in conformity with a comprehensive basis of accounting other than generally accepted accounting principles should include disclosure of the basis of accounting used.

Reporting When the CPA Is Not Independent

17. A CPA is not precluded from issuing a report with respect to his compilation of financial statements for an entity as to which he is not independent, as that term is defined and interpreted in the Code of Professional Ethics of the AICPA. However, since users typically assume that the CPA is independent, in such circumstances the CPA should include the following as the last paragraph of his report:

I am (we are) not independent with respect to XYZ Company.

REVIEW OF FINANCIAL STATEMENTS

Objective of Review

18. The objective of a review of financial statements is to achieve, through the performance of inquiry and analytical procedures, limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles or, if applicable, with another

⁵ See paragraphs 34 and 35 for guidance when the CPA is aware of other departures from generally accepted accounting principles.

comprehensive basis of accounting. (The financial statements reviewed by a CPA may also have been compiled by the CPA. In such circumstances, the reporting standards for a review service are applicable.)

19. The objective of a review service differs significantly from the objective of a compilation service. Inquiry and analytical procedures performed in a review service should provide the CPA with limited assurance that there are no material modifications that should be made to the financial statements. No such assurance is contemplated in a compilation service.

20. The objective of a review service also differs significantly from that of an audit, which is to provide a reasonable basis for expressing an opinion regarding the financial statements taken as a whole. A review service does not provide a basis for the expression of such an opinion. In a review service, a CPA accepts representations from the entity; in an audit, a CPA studies and evaluates internal accounting control as a basis for reliance thereon and obtains corroborating evidential matter through inspection, observation, and confirmation to support client representations.

Review Standards

21. The CPA should obtain a level of knowledge of the accounting principles and practices of the industry in which the entity operates and an understanding of the entity's business⁶ in order to perform inquiry and analytical procedures that will enable him to achieve limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with generally accepted accounting principles or another comprehensive basis of accounting.

22. The requirement that the

CPA obtain a level of knowledge of the accounting principles and practices of the industry in which the entity operates does not prevent a CPA from accepting a review engagement for an entity in an industry with which the CPA has no previous experience. It does, however, place upon the CPA a responsibility to obtain the required level of knowledge. He may do so, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, or individuals knowledgeable about the industry.

23. The CPA's understanding of the entity's business should include a general understanding of the entity's organization, its operating characteristics, and the nature of its assets, liabilities, revenues, and expenses. This would ordinarily involve a general knowledge of the entity's production, distribution, and compensation methods, types of products and services, operating locations, and material transactions with related parties. A CPA's understanding of an entity's business is ordinarily obtained through experience with the entity or its industry and inquiry of personnel of the entity.

24. The CPA's inquiry and analytical procedures should ordinarily consist of the following:

- a. Inquiries concerning the entity's accounting principles and practices and the methods followed in applying them (see Appendix A).
- b. Inquiries concerning the entity's procedures for recording, classifying and summarizing transactions, and accumulating information for disclosure in the financial statements (see Appendix A).
- c. Analytical procedures designed to identify relationships and individual items that appear to be unusual. Analytical procedures consist of (1) the systematic comparison of current financial information with that of a prior period or periods and also

with budgeted and similar information for the current period, if available; (2) a study of the interrelationships of elements of financial statements that would be expected to conform to a predictable pattern based on the entity's experience; and (3) a consideration of the types of matters that required accounting adjustments in preceding periods. Examples of interrelationships of elements in financial statements that would be expected to conform to a predictable pattern may be the relationships between changes in sales and changes in accounts receivable and expense accounts that ordinarily fluctuate with sales, and between changes in property, plant, and equipment, and changes in depreciation expense and other accounts that may be affected, such as maintenance and repairs.

- d. Inquiries concerning actions taken at meetings of stockholders, board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements.
- e. Reading the financial statements to consider, on the basis of information coming to the CPA's attention, whether the financial statements appear to conform with generally accepted accounting principles or, if applicable, with another comprehensive basis of accounting.
- f. Obtaining reports from other CPAs, if any, who have been engaged to audit or review the financial statements of significant components of the reporting entity, its subsidiaries, and other investees.
- g. Inquiries of persons having responsibility for financial and accounting matters concerning (1) whether the financial statements have been prepared in conformity with generally accepted accounting principles or with another

⁶ For purposes of this Statement, business refers to both profit and not-for-profit entities.

comprehensive basis of accounting, consistently applied; (2) changes in the entity's business activities or accounting principles and practices; (3) matters as to which questions have arisen in the course of applying the foregoing procedures; and (4) events subsequent to the date of the financial statements that would have a material effect on the financial statements.

25. When performing a review service, a CPA accepts representations from the entity and has no obligation to perform any procedures of a corroborative nature. However, if the CPA believes that information coming to his attention is incorrect, incomplete, or otherwise unsatisfactory, the CPA should perform the additional procedures he deems necessary to achieve limited assurance that there are no material modifications that should be made to the financial statements. (See paragraph 30 for guidance when a CPA is unable to complete a review service and paragraphs 34 and 35 for the CPA's responsibilities when he is aware of departures from generally accepted accounting principles or another comprehensive basis of accounting.)

26. Although it is not possible to specify the form or content of the working papers that a CPA should prepare in connection with a review of financial statements because of the different circumstances of individual engagements, the CPA's working papers should describe:

- a. The matters covered in the CPA's inquiry and analytical procedures.
- b. Unusual matters or significant aspects of the engagement that the CPA considered during the performance of the review service, including their disposition.

27. The CPA may wish to obtain a representation letter from the owner, manager, or chief executive officer, and, if appropriate, the chief financial officer. An example of a

representation letter is presented in Appendix D to this Statement.

Reporting on the Financial Statements

28. Financial statements reviewed by a CPA should be accompanied by a report from the CPA stating that:

- a. A review service was performed in accordance with standards promulgated by the American Institute of Certified Public Accountants.
- b. A review service is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements taken as a whole and, accordingly, such an opinion is not expressed.
- c. All information included in the financial statements is the representation of the management (owners) of the entity.
- d. The CPA is not aware of any material modifications that should be made to the financial statements other than those modifications, if any, indicated in his report.

Each page of the financial statements reviewed by a CPA should include a reference to his report, such as "See Accompanying CPA's Report." The date of completion of the CPA's inquiry and analytical procedures should be used as the date of the CPA's report.

29. The following form of standard report is appropriate for a review service:⁷

I (we) have performed a review of the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards promulgated by the American Institute of Certified Pub-

lic Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles (other comprehensive basis of accounting).

30. When a CPA is unable to perform the inquiry and analytical procedures he considers necessary to achieve the limited assurance contemplated by a review service, his review will be incomplete. A review that is incomplete is not an adequate basis for issuing a review report by a CPA. In such a situation, the CPA should carefully consider whether the circumstances resulting in an incomplete review also preclude the CPA from issuing a compilation report on the entity's financial statements (see paragraph 10).

31. A CPA may be asked to report on one financial statement, such as a balance sheet, and not on other related financial statements, such as the statements of income, retained earnings, and changes in financial position. He may do so if the scope of his inquiry and analytical procedures has not been restricted.

32. A CPA is precluded from issuing a review report on the financial statements of an entity as to which he is not independent, as that term is defined and interpreted in the Code of Professional Ethics of the AICPA. However, in such circumstances, the CPA may issue a compilation report provided he complies with the compilation standards.

⁷ See paragraphs 34 and 35 for guidance when a CPA is aware of departures from generally accepted accounting principles or another comprehensive basis of accounting.

OTHER STANDARDS APPLICABLE TO BOTH COMPILATION AND REVIEW SERVICES

Reports on Comparative Financial Statements

33. When prior-period financial statements are presented with current-period financial statements for comparative purposes, the CPA should issue an appropriate report covering each period presented.

Departures From Generally Accepted Accounting Principles or Another Comprehensive Basis of Accounting

34. The CPA may become aware of a departure from generally accepted accounting principles or another comprehensive basis of accounting that is material to the financial statements (other than the omission, in a compilation engagement, of substantially all disclosures as discussed in paragraphs 14-16). If the financial statements are not modified, the CPA should revise the final paragraph of his report to indicate that he is aware of the departure and should also disclose the departure in a separate paragraph of his report, including the effects of the departure on the financial statements if such effects have been determined by management or are known as the result of the CPA's procedures. (This requirement includes disclosure of the effect of changes in accounting principles.) The CPA is not required to determine the effects of a departure if management has not done so, provided the CPA states in his report that such determination has not been made. Examples of reports on compilation and review services that disclose departures from generally accepted accounting principles are as follows:

a. Compilation service

I (we) have performed a compilation service in connection with the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended. All information included in the financial statements is the representation of the management (owners) of XYZ Company.

Users of these financial statements should be aware that a compilation service is limited to the presentation in the form of financial statements of information supplied by management (owners) and that I (we) have not achieved any assurance as to whether there are material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles (other comprehensive basis of accounting). However, I (we) did become aware of a departure (certain departures) from generally accepted accounting principles that is (are) described in the following paragraph(s).

(Separate paragraph)

Generally accepted accounting principles require that land be stated at cost. Management has informed me (us) that the Company has stated its land at appraised value and that, if generally accepted accounting principles had been followed, the land account and stockholders' equity would have been decreased by \$500,000.

or

A statement of changes in financial position for the year ended December 31, 19XX, has not been presented. Generally accepted accounting principles require that such a statement be presented when financial statements purport to present financial position and results of operations.^a

b. Review service

I (we) have performed a review of the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards promulgated by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than

an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, with the exception of the matters described in the following paragraph(s), I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles (other comprehensive basis of accounting).

(Separate paragraph)

As described in Note X to the financial statements, generally accepted accounting principles require that inventory cost consist of material, labor, and overhead. Management has informed me (us) that the inventory of finished goods and work in process is stated in the accompanying financial statements at material cost only, and that the effects of this departure from generally accepted accounting principles on financial position, results of operations, and changes in financial position have not been determined.

or

As disclosed in Note X to the financial statements, the Company has adopted (description of newly adopted method), whereas it previously used (description of previous method). Although the (description of newly adopted method) is in conformity with generally accepted accounting principles, the Company does not appear to have reasonable justification for making a change as required by Opinion No. 20 of the Accounting Principles Board.

35. If the effect of a departure from generally accepted accounting principles or another comprehensive basis of accounting is so material to the financial statements taken as a whole that the CPA believes expansion of his report as described in paragraph 34 is not adequate to indicate the deficiencies in the financial statements taken as a whole, the CPA should withdraw from the compilation or review engagement and provide no further services with respect to those financial statements.

^a If a statement of changes in financial position is not presented, the first paragraph of the compilation report should be modified accordingly.

APPENDIX A
REVIEW OF FINANCIAL STATEMENTS
ILLUSTRATIVE INQUIRIES

The inquiries to be made in a review of financial statements are a matter of the CPA's judgment. In determining his inquiries, a CPA may consider (a) the nature and materiality of the items; (b) likelihood of misstatement; (c) knowledge obtained during current and previous engagements; (d) the stated qualifications of the entity's accounting personnel; (e) the extent to which a particular item is affected by management's judgment; and (f) inadequacies in the entity's underlying financial data. The following list of inquiries is for illustrative purposes only. The CPA is not required to corroborate information obtained by such inquiries unless he believes that such information is incorrect, incomplete, or otherwise unsatisfactory (see paragraph 25 of the proposed Statement). The inquiries do not necessarily apply to every engagement, nor are they meant to be all-inclusive.

1. General

- (a) What are the procedures for recording, classifying, and summarizing transactions (relates to each section discussed below)?
- (b) Do the general ledger control accounts agree with subsidiary records (for example, receivables, inventories, investments, fixed accounts payable, accrued expenses, non-current liabilities)?
- (c) Have accounting principles been applied on a consistent basis?

2. Cash

- (a) Have bank balances been reconciled with book balances?
- (b) Have old or unusual reconciling items between bank balances and book balances been reviewed and adjustments made where necessary?
- (c) Has a proper cutoff of cash transactions been made?
- (d) Have cash funds been counted and reconciled with control accounts?

3. Receivables

- (a) Has an adequate allowance been made for doubtful accounts?
- (b) Have receivables considered uncollectible been written off?
- (c) If appropriate, has interest been reflected?
- (d) Has a proper cutoff of sales transactions been made?
- (e) Are there any receivables from employees and related parties?
- (f) Are any receivables pledged, discounted, or factored?

4. Inventories

- (a) Have inventories been physically counted? If not, how have inventories been determined?
- (b) Have general ledger control accounts been adjusted to agree with physical inventories?
- (c) If physical inventories are taken at a date other than the end of the entity's fiscal year, what procedures were used to record changes in inventory between the date of the physical inventory and the end of the fiscal year?
- (d) Were consignments in or out considered in taking physical inventories?
- (e) What is the basis of valuation?
- (f) Have write-downs for obsolescence or cost in excess of net realizable value been made?
- (g) Have proper cutoffs of purchases, goods in transit, and returned goods been made?
- (h) Are there any inventory encumbrances?

5. Prepaid Expenses

- (a) What is the nature of the amounts included in prepaid expenses?
- (b) How are these amounts amortized?

6. Investments Including Loans, Mortgages, and Intercorporate Investments
 - (a) Have gains and losses on disposal been reflected?
 - (b) Has investment income been reflected?
 - (c) Have investments been classified between current and non-current?
 - (d) Have consolidation or equity accounting requirements been considered?
 - (e) If there is an indication of permanent impairment in the value of an investment, including marketable securities classified as non-current, has adequate allowance been made for such impairment?
 - (f) What is the basis of valuation of marketable equity securities?
7. Property and Equipment
 - (a) Have gains or losses on disposal of property or equipment been reflected?
 - (b) What are the criteria for capitalization of property and equipment? Have such criteria been applied during the fiscal period?
 - (c) Does the repairs and maintenance account only include items of an expense nature?
 - (d) Are property and equipment stated at cost?
 - (e) What are the depreciation methods and rates? Are they appropriate and consistent?
 - (f) Are there any unrecorded additions, retirements, abandonments, sales, or trade-ins?
 - (g) Does the entity have material lease agreements? Have they been properly reflected?
 - (h) Is any property or equipment mortgaged or otherwise encumbered?
8. Other Assets
 - (a) What is the nature of the amounts included in other assets?
 - (b) Do these assets represent costs that will benefit future periods? What is the amortization policy? Is it appropriate?
 - (c) Have other assets been classified between current and non-current?
9. Accounts and Notes Payable and Accrued Liabilities
 - (a) Have all significant payables been reflected?
 - (b) Are all bank and other short-term liabilities properly classified?
 - (c) Have all significant accruals, such as payroll, interest, and contributions to pension and profit-sharing plans been reflected?
 - (d) Are there any collateralized liabilities?
 - (e) Are there any payables to employees and related parties?
10. Long-Term Liabilities
 - (a) What are the terms and other provisions of long-term liability agreements?
 - (b) Have liabilities been classified between current and non-current?
 - (c) Has interest expense been reflected?
 - (d) Has there been compliance with restrictive covenants of loan agreements?
 - (e) Are any long-term liabilities collateralized?
11. Income and Other Taxes
 - (a) Has provision been made for current and prior year federal income taxes payable?
 - (b) Have any assessments or reassessments been received? Are there tax examinations in process?
 - (c) Are there timing differences? If so, have deferred taxes been reflected?
 - (d) Has provision been made for state and local income, franchise, sales, and other taxes payable?
12. Other Liabilities
 - (a) What is the nature of the amounts included in other liabilities?
 - (b) Have other liabilities been classified between current and non-current?
 - (c) Are there any contingent liabilities, such as discounted notes, drafts, endorsements, warranties, litigation, and unsettled asserted claims? Are there any unasserted potential claims?
 - (d) Are there any material contractual obligations for construction or purchase of real property and equipment and any commitments or options to purchase or sell company securities?
13. Equity
 - (a) What is the nature of any changes in equity accounts?
 - (b) What classes of capital stock have been authorized?
 - (c) Do amounts of outstanding shares of capital stock agree with subsidiary records?
 - (d) Have capital stock preferences, if any, been disclosed?
 - (e) Have stock options been granted?
 - (f) Has the entity made any acquisitions of its own capital stock?

14. Income and Expenses

- (a) Are revenues from the sale of major products and services recognized in the appropriate period?
- (b) Are purchases and expenses recognized in the appropriate period and properly classified?
- (c) Do the financial statements include discontinued operations or items that might be considered extraordinary?

15. Other

- (a) Are there any events which occurred after the end of the fiscal period that have a significant effect on the financial statements?
- (b) Have actions taken at stockholder, board of directors, or comparable meetings that affect the financial statements been reflected?
- (c) Have there been any material transactions between related parties?
- (d) Are there any material uncertainties? Is there any change in the status of material uncertainties previously disclosed?
- (e) Is the entity required to report segment information in accordance with FASB Statement No. 14?

APPENDIX B

**COMPILATION OF FINANCIAL STATEMENTS
ILLUSTRATIVE ENGAGEMENT LETTER**

(Appropriate Salutation)

This letter is to confirm our understanding of the terms of our engagement and the nature and extent of the services we will provide.

We will perform the following services:

1. We will compile, from information you provide, the annual and interim balance sheets and related statements of income, retained earnings, and changes in financial position of XYZ Company for the year 19XX. We will not audit or review such financial statements. Our report on the annual financial statements of XYZ Company is presently expected to read as follows:

We have performed a compilation service in connection with the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

Users of these financial statements should be aware that a compilation service is limited to the presentation in the form of financial statements of information supplied by management (owners) and that I (we) have not achieved any assurance as to whether there are material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles (other comprehensive basis of accounting).

Our report on your interim financial statements, which statements will omit substantially all disclosures, will include an additional paragraph that will read as follows:

Users of these financial statements should also be aware that management has elected to omit substantially all of the disclosures (and the statement of changes in financial position) required by generally accepted accounting principles (other comprehensive basis of accounting). If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the Company's financial position, results of operations, and changes in financial position.

If, for any reason, we are unable to complete the compilation of your financial statements, we will not issue a report on such statements as a result of this engagement.

2. We will also . . . (discussion of other services).

Our engagement should not be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, we will inform you of any matters that come to our attention which cause us to believe that such a condition may exist.

Our fees for these services. . . .

We shall be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.¹

Sincerely yours,

(Signature of CPA)

Acknowledge:
XYZ Company

President

Date

¹ Some CPAs prefer not to obtain an acknowledgement, in which case their letter would omit the paragraph beginning "If the foregoing. . . ." and the spaces for acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms of our engagement. . . ."

APPENDIX C

**REVIEW OF FINANCIAL STATEMENTS
ILLUSTRATIVE ENGAGEMENT LETTER**

(Appropriate Salutation)

This letter is to confirm our understanding of the terms of our engagement and the nature and extent of the services we will provide.

We will perform the following services:

1. We will perform a review of the balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards promulgated by the American Institute of Certified Public Accountants. We will not audit such financial statements and, accordingly, we will not express an opinion on them. Our report on the financial statements is presently expected to read as follows:

We have performed a review of the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards promulgated by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of XYZ Company.

A review consists of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles (other comprehensive basis of accounting).

If, for any reason, we are unable to complete our review of your financial statements, we will not issue a report on such statements as a result of this engagement.

2. We will also . . . (discussion of other services).

Our engagement should not be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, we will inform you of any matters that come to our attention which cause us to believe that such a condition may exist.

Our fees for these services. . . .

We shall be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.¹

Sincerely yours,

(Signature of CPA)

Acknowledge:

XYZ Company

President

Date

¹ Some CPAs prefer not to obtain an acknowledgement, in which case their letter would omit the paragraph beginning "If the foregoing. . . ." and the spaces for acknowledgement. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms of our engagement. . . ."

APPENDIX D
REVIEW OF FINANCIAL STATEMENTS
ILLUSTRATIVE REPRESENTATION LETTER¹

(Date of CPA's Report)

(To the CPA)

In connection with your review of the (identification of financial statements) of (name of client) as of (date) and for the (period of review) for the purpose of achieving limited assurance that there are no material modifications that should be made to the statements in order for them to be in accordance with generally accepted accounting principles (other comprehensive basis of accounting), we confirm, to the best of our knowledge and belief, the following representations made to you during your review.

1. The financial statements referred to above present the financial position, results of operations, and changes in financial position of (name of client) in conformity with generally accepted accounting principles (other comprehensive basis of accounting). In that connection, we specifically confirm that:
 - (a) The Company's accounting principles, and the practices and methods followed in applying them, are as disclosed in the financial statements.
 - (b) There have been no changes during the (period reviewed) in the Company's accounting principles and practices.
 - (c) We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
 - (d) There are no material transactions that have not been properly reflected in the financial statements.
 - (e) There are no material losses (such as from obsolete inventory or purchase or sales commitments) that have not been properly accrued or disclosed in the financial statements.
 - (f) There are no violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency and there are no other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by Statement of Financial Accounting Standards No. 5.
 - (g) The Company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged.
 - (h) There are no related party transactions or related amounts receivable or payable that have not been properly disclosed in the financial statements.
 - (i) We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
 - (j) No events have occurred subsequent to the balance sheet date that would require adjustment to, or disclosure in, the financial statements.
2. We have advised you of all actions taken at meetings of stockholders, board of directors, and committees of the board of directors (or other similar bodies, as applicable) that may affect the financial statements.
3. We have responded fully to all inquiries made to us by you during your review.

(Name of Owner or Chief Executive
Officer and Title)

(Name of Chief Financial Officer
and Title)

¹ The illustrative letter assumes that there are no matters requiring specific disclosure to the CPA. If matters requiring specific disclosure exist, the letter should be appropriately modified to include such matters.